DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 02-0305
Financial Institutions Tax
For the Tax Years 1995 through 2000

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ISSUES

I. Constitutionality of the Financial Institutions Tax.

Authority: Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977); IC 6-5.5-1-12, 13; IC 6-5.5-1-17(a); IC 6-5.5-2-1(a); IC 6-5.5-2-2; IC 6-5.5-2-3; IC 6-5.5-3-1(6); 45 IAC 17-3-5(a).

Taxpayer argues that because it is an out-of-state entity having only minimal contacts with Indiana, the imposition of the Financial Institutions Tax (FIT) violates the Commerce Clause.

II. Abatement of the Ten-Percent Negligence Penalty.

Authority: IC 6-8.1-10-2.1; IC 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer maintains that its failure to file FIT returns was not due to negligence and that it is entitled to request an abatement of the ten-percent negligence penalty imposed at the conclusion of the audit examination.

STATEMENT OF FACTS

Taxpayer and its subsidiaries (hereinafter collectively "taxpayer") are financial institutions. Taxpayer is incorporated in a state outside Indiana and maintains its commercial domicile in another state outside Indiana. Taxpayer earns money from Indiana customers by issuing credit cards, collecting interest on charges made to those cards, and by financing the purchase of automobiles.

The Department of Revenue (Department) conducted an audit review of taxpayer's various business operations and determined that it came within the purview of the state's Financial Institutions Tax (FIT). Taxpayer had not filed a FIT return for any of the years considered during the audit review.

The Department concluded that taxpayer owed FIT taxes during the years 1995 through 2000. A proposed assessment of those taxes was issued to the taxpayer. In response, taxpayer challenged the assessment, an administrative hearing was held during which taxpayer explained the grounds for its protest, and this Letter of Findings results.

DISCUSSION

I. Constitutionality of the Financial Institutions Tax.

Four of taxpayer's business divisions were included in the proposed FIT assessment. Taxpayer maintains that three of those divisions do not have "nexus" with Indiana and that the assessment rendered against those three divisions was inappropriate. The fourth division – the car finance company – maintained a salesman within this state. The salesman's job was to encourage Indiana car dealerships to offer the car finance company's services to individual car customers. However, taxpayer argues that this fourth division is also not subject to the state's FIT because the 'salesman's activity in the state was restricted to mere solicitation of customers."

For all four of its business divisions, taxpayer's argument is that its contact with Indiana is so attenuated that imposition of FIT violates the Commerce Clause (U.S. Const. art. I, § 8).

Within Indiana, "There is imposed on each taxpayer a franchise tax measured by the taxpayer's adjusted gross income or apportioned income for the privilege of exercising its franchise or the corporate privilege of transacting the business of a financial institution in Indiana." IC 6-5.5-2-1(a).

For purposes of the FIT, a "'[t]axpayer' means a corporation that is transacting the business of a financial institution, including any of the following:

> (1) A holding company.
> (2) A regulated financial corporation.
> (3) A subsidiary of a holding company or regulated financial corporation.
> (4) Any other corporation organized under the laws of the United States, this state, another taxing jurisdiction, or a foreign government that is carrying on the business of a financial institution." IC 6-5.5-1-17(a).

The FIT is imposed on both "nonresident taxpayers" and "resident taxpayers" transacting business within this state. IC 6-5.5-1-12, 13. The statute defines a "nonresident taxpayer" as "a taxpayer that (1) is transacting business within Indiana as provided in IC 6-5.5-3; and (2) has its commercial domicile outside Indiana." A resident taxpayer, not filing a combined return, determines its FIT liability based on the resident taxpayer's adjusted gross income from whatever source derived. IC 6-5.5-2-2. In contrast, a nonresident taxpayer determines its FIT liability based on its apportioned income consisting of the taxpayer's adjusted gross income "multiplied by the quotient of (1) the taxpayer's total

receipts attributable to transacting business in Indiana . . . divided by (2) the taxpayer's total receipts from transacting business in all jurisdictions . . . ." IC 6-5.5-2-3.

The FIT definition of "transacting business" within this state includes the activities of a company which "regularly engages in transactions with customers in Indiana that involve intangible property, including loans . . . [that] result in receipts flowing to the taxpayer from within Indiana." IC 6-5.5-3-1(6).

Taxpayer challenges the FIT assessment on the ground that it does not have a substantial nexus with Indiana. In Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), the Supreme Court stated that a tax will not be deemed to interfere with interstate commerce when it is "applied to an activity with a substantial nexus within the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state." Id. at 279. Taxpayer's protest is based on the assertion that it does not have the minimum connection with the state necessary to establish the requisite "substantial nexus."

To the extent taxpayer maintains that Indiana's FIT is – on its face – inapplicable, the Department must disagree. Under IC 6-5.5-3-1, IC 6-5.5-1-12, and IC 6-5.5-1-17, taxpayer falls squarely within the definition of a non-resident entity conducting the business of a financial institution within this state; consequently, taxpayer is liable for FIT on the income derived from sources within Indiana. Because the four divisions are part of a "unitary business," the audit correctly determined that taxpayer was required to "file a combined return covering all the operations of the unitary business . . . ." 45 IAC 17-3-5(a).

To the extent taxpayer facially challenges the constitutionality of the FIT as applied to non-resident businesses having only an economic nexus with Indiana, the Department declines to address the question raised.

FINDING

Taxpayer's protest is respectfully denied.

II. Abatement of the Ten-Percent Negligence Penalty.

Taxpayer requests that the Department exercise its discretion to abate the ten-percent negligence penalty.

IC 6-8.1-10-2.1 requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ."

Taxpayer did not file FIT tax returns, was audited during 2002, and was assessed for six years of unpaid taxes. Taxpayer is a substantial, sophisticated business receiving large amounts of money from sources within Indiana. Taxpayer's larger constitutional question aside, the decision to ignore its actual or potential liability under the state's FIT is not the evidence of the "ordinary business care and prudence" expected of an "ordinary reasonable taxpayer" that would warrant abatement of the ten-percent negligence penalty.

FINDING

Taxpayer's protest is respectfully denied.

DK/JM/MR – 031505